CITY OF BALTIMORE

WATER UTILITY FUND

FINANCIAL STATEMENTS

FOR THE FISCAL YEARS ENDED

JUNE 30, 2000 AND 1999

(WITH INDEPENDENT AUDITORS' REPORT THEREON)

CITY OF BALTIMORE
WATER UTILITY FUND
FINANCIAL STATEMENTS
JUNE 30, 2000 AND 1999

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CITY OF BALTIMORE
MARTIN O'MALLEY, Mayor
DEPARTMENT OF AUDITS
Room 321, City Hall
Baltimore, Maryland 21202

KPMG
111 South Calvert Street
Baltimore, MD 21202

Independent Auditors' Report

December 22, 2000

The Mayor, City Council, Comptroller and
Board of Estimates of the City of Baltimore, Maryland

We have audited the accompanying balance sheets of the Water Utility Fund of the City of Baltimore, Maryland, as of June 30, 2000 and 1999, and the related statements of revenues, expenses and changes in equity and cash flows for the years then ended. These financial statements are the responsibility of the City of Baltimore, Maryland's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

As discussed in Note 1, the financial statements present only the Water Utility Fund of the City of Baltimore, Maryland, and are not intended to present fairly the financial position of the City of Baltimore, Maryland, and the results of its operations and the cash flows of its proprietary fund types and nonexpendable trust funds in conformity with accounting principles generally accepted in the United States of America.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Water Utility Fund of the City of Baltimore, Maryland, as of June 30, 2000 and 1999, and the results of its operations and its cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America.

Yovonda D. Brooks
City Auditor
Department of Audits

KPMG LLP
Certified Public Accountants

CITY OF BALTIMORE
WATER UTILITY FUND
BALANCE SHEETS
JUNE 30, 2000 AND 1999
(Expressed in Thousands)

	2000	1999
ASSETS		
Property, plant and equipment, net	$406,293	$373,157
Current assets:		
Cash and cash equivalents	5,905	8,656
Accounts receivable, net	12,563	10,720
Unbilled water utility user charges	16,201	12,268
Inventories	4,682	3,313
Total current assets	39,351	34,957
Restricted assets - cash and cash equivalents, investments and receivables restricted for:		
Future capital expenditures	38,682	28,861
Revenue bond debt service	22,648	18,686
Revenue bond contingency	2,284	2,167
Total restricted assets	63,614	49,714
Unamortized bond issuance costs	4,510	4,580
Total assets	$513,768	$462,408
LIABILITIES AND EQUITY		
Equity:		
Contributed capital	$196,832	$181,764
Retained earnings:		
Reserved for revenue bond debt service	24,932	20,853
Unreserved	66,625	61,638
Total equity	288,389	264,255
Liabilities:		
Long-term obligations:		
General obligation bonds, net	1,685	2,185
Revenue bonds payable, net	201,086	175,097
Vested compensated absences	3,373	3,070
Total long-term obligations	206,144	180,352
Current liabilities:		
Accounts payable from restricted assets	5,676	5,523
Accounts payable and accrued liabilities	2,495	2,160
Accrued interest payable	4,406	4,427
Deposits subject to refund	14	9
Due to other funds - City of Baltimore	948	948
Due to other governments	2,157	1,250
Current portion of long-term obligations	3,539	3,484
Total current liabilities	19,235	17,801
Total liabilities	225,379	198,153
Total liabilities and equity	$513,768	$462,408

See notes to financial statements.

CITY OF BALTIMORE
WATER UTILITY FUND
STATEMENTS OF REVENUES, EXPENSES AND CHANGES IN EQUITY
YEARS ENDED JUNE 30, 2000 AND 1999
(Expressed in Thousands)

	2000	1999
Operating revenues - charges for services	$79,427	$72,949
Operating expenses:		
Salaries and wages	25,226	25,546
Other personnel costs	7,886	7,401
Contractual services	18,885	17,291
Materials and supplies	4,564	5,428
Minor equipment	661	1,120
General government overhead	3,735	3,536
Bad debts	1,277	458
Depreciation	7,417	7,389
Amortization of bond issuance costs	175	180
Total operating expenses	69,826	68,349
Operating income	9,601	4,600
Non-operating expenses:		
Interest expense, net	(1,975)	(927)
Loss on sale of investments	(25)	(16)
Net non-operating expenses	(2,000)	(943)
Net income	7,601	3,657
Add depreciation on fixed assets acquired by contributed capital	1,465	1,351
Increase in retained earnings	9,066	5,008
Retained earnings, beginning of year	82,491	77,483
Retained earnings, end of year	91,557	82,491
Contributed capital, beginning of year	181,764	170,493
Additions	16,533	12,622
Less depreciation on fixed assets acquired by contributed capital	(1,465)	(1,351)
Contributed capital, end of year	196,832	181,764
Total equity	$ 288,389	$ 264,255

See notes to financial statements.

CITY OF BALTIMORE
WATER UTILITY FUND
STATEMENTS OF CASH FLOWS
YEARS ENDED JUNE 30, 2000 AND 1999
(Expressed in Thousands)

	2000	1999
Cash flows from operating activities:		
Operating income	$9,601	$4,600
Adjustments to reconcile operating income to net cash provided by operating activities:		
Depreciation	7,417	7,389
Amortization of bond issuance costs	175	180
(Increase) in accounts receivable, net	(5,776)	(729)
(Increase) in inventories	(1,369)	(646)
(Increase) in issuance costs	(105)	-
Increase (decrease) in accounts payable and accrued liabilities	335	(80)
Increase in vested compensated absences	303	118
Amortization of early extinguishment of debt	274	-
Increase in deposits subject to refund	5	-
Increase (decrease)in accrued interest payable	(21)	595
Increase (decrease) in due to other governments	907	(451)
(Decrease) in due to other funds - City of Baltimore	-	(20)
Net cash provided by operating activities	11,746	10,956
Cash flows from capital and related financing activities:		
Proceeds from sale of bonds, net	40,888	12,008
Acquisition and construction of capital assets	(40,553)	(43,227)
Changes in restricted assets	(26,416)	1,074
Changes in restricted accounts payable	153	1,871
Principal paid on revenue bonds	(2,940)	(2,465)
Principal paid on general obligation bonds	(695)	(681)
Principal paid on BANs	(12,000)	-
Interest paid	(3,409)	(3,447)
Capital contributions	16,533	12,622
Net cash used by capital and related financing activities	(28,439)	(22,245)
Cash flows from investing activities:		
Purchase of investments	-	(16)
Interest on investments	1,426	2,528
Net cash provided by investing activities	1,426	2,512
Net decrease in cash and cash equivalents	(15,267)	(8,777)
Cash and cash equivalents, beginning of year	32,412	41,189
Cash and cash equivalents, end of year	$17,145	$32,412

See notes to financial statements.

CITY OF BALTIMORE
WATER UTILITY FUND
NOTES TO FINANCIAL STATEMENTS

1. Description of the Utility:

The Water Utility (the Utility) is a separate utility within the Bureau of Water and Waste Water, which is one of the four bureaus in the City of Baltimore, Maryland's Department of Public Works. In November 1978, the voters approved a Charter Amendment establishing the Utility as a separate enterprise and required it to be financially self-sustaining and operated without profit or loss to the other funds or programs of Baltimore City (the City).

These financial statements are only of the Utility's operations and are not intended to present the financial position of the City, and the results of its operations and the cash flows of its proprietary fund types and nonexpendable trust funds in conformity with accounting principles generally accepted in the United States of America (GAAP).

2. Summary of Significant Accounting Policies:

The accounting and financial reporting policies of the Utility conform to GAAP and reporting standards as promulgated by the Governmental Accounting Standards Board (GASB) for proprietary funds.

GAAP allows governments to choose either not to implement, in proprietary fund types, pronouncements of the Financial Accounting Standards Board (FASB) issued after November 30, 1989, unless those pronouncements are specifically adopted by GASB (provided that this is applied on a consistent basis) or to continue to follow FASB standards for these fund types. The Utility has elected not to implement FASB pronouncements issued after that date for its proprietary fund types.

Basis of Accounting:

The financial statements have been prepared on the accrual basis of accounting whereby revenues are recorded at the time they are earned and expenses are recorded when incurred.

Cash and Cash Equivalents:

Cash and cash equivalents include amounts in demand deposits, as well as short-term investments with a maturity date within three months of the date acquired by the Utility.

Investments:

Investments with maturities of less than one year from purchase date are reported at cost which approximates fair value. Other investments are reported at fair value. Securities traded on national exchanges are valued at the last reported sales price.

Inventories:

Inventories are stated at cost, using the moving average cost method.

Unbilled Water Utility User Charges:

Unbilled water user charges are estimated and accrued at year-end.

Property, Plant and Equipment:

Property, plant and equipment are stated at cost. Depreciation is computed using the straight-line method over the estimated useful lives, as follows:

Buildings…………..	50 years
Improvements………	50 years
Equipment………….	25 years
Mobile Equipment….	5-10 years

Depreciation recognized on assets acquired or constructed with contributed capital is transferred to contributed capital.

Amortization:

Bond issuance costs are amortized over the life of the issue using the straight-line method, the effect of which is not materially different than under the effective interest method. Gains and losses on the early extinguishment of debt are amortized over the shorter of the life of the new or old debt.

Sick, Vacation and Personal Leave:

Employees earn one day of sick leave for each completed month of service; there is no limitation on the number of sick leave days that may be accumulated. A portion of unused sick leave earned annually during each twelve-month period may be converted to cash for a maximum of three days, computed on an attendance formula. Upon retirement with pension benefits, or termination of employment after completion of twenty or more years of service without pension benefits, employees receive one day's pay for every four sick leave days accumulated and unused as of the date of separation; under any other conditions of separation, unused sick leave is forfeited. At June 30, 2000, it is estimated that accumulated non-vested sick leave for the Utility approximated $3,568,000. Sick leave benefit expenses are not recorded until paid, except that vested unused sick leave for employees with 20 or more years of service is recorded when leave is earned.

Employees can accumulate a maximum of 224 vacation and personal leave days depending upon length of service, which may be taken either through time off or carried until paid upon termination or retirement. Accumulated vacation and personal leave expenses are recorded when leave is earned.

The total vacation, personal leave and vested unused sick leave recorded as a liability at June 30, 2000 and 1999 is $3,373,000 and $3,070,000, respectively.

3. Cash and Cash Equivalents:

The Utility participates in the City's pooled cash account. At June 30, 2000 and 1999, the Utility's share of the City's pooled cash account, including both restricted and unrestricted cash, was $8,431,000 and $16,353,000, respectively. All of the City's pooled cash deposits are either covered by Federal depository insurance, collateralized by securities held in the name of the City by the City's agent, or collateralized by securities held by the pledging financial institutions' trust departments in the City's name.

In accordance with state law, the City is authorized to invest in direct or indirect obligations of the U.S. government, certificates of deposit, repurchase agreements and related mutual funds. City policy requires that securities underlying repurchase agreements must have a market value of at least 100% of the cost of the repurchase agreement and the City takes possession of the securities when the repurchase agreement's maturity is over five days. Management believes the City has complied with this policy throughout the year.

Investments at June 30, 2000 and 1999 are summarized below. Investments represented by specific identifiable investment securities are classified as to credit risk by the three categories below:

Category 1 - Insured or registered, or securities held by the City or its agent in the City's name.
Category 2 - Uninsured and unregistered, with securities held by the counterparty's trust department or agent in the City's name.
Category 3 - Uninsured and unregistered, with securities held by the counterparty or by its trust department or agent but not in the City's name.

	(Expressed in Thousands)		
	Category		Carrying
2000:	1	2	Value
Repurchase agreements…………………………..	-	$32,600	$32,600
U.S. Treasury and Agencies………………………..	$9,284	-	9,284
	$9,284	$32,600	41,884
Mutual funds……………………………………..			8,715
			$50,599

	Category		Carrying
1999:	1	2	Value
Repurchase agreements…………………………..	-	$11,900	$ 11,900
U.S. Treasury and Agencies……………………...	$440	-	440
	$440	$11,900	12,340
Mutual funds……………………………………..			16,059
			$28,399

4. Restricted Assets:

Restricted assets consist of resources that are legally obligated for the acquisition and improvement of capital facilities and revenue bond repayment requirements. Restricted assets at June 30 are as follows (amounts expressed in thousands):

	2000	1999
Cash and cash equivalents……	$11,240	$23,756
Investments…………………...	41,884	12,340
Accounts receivable…………..	8,074	5,067
Due from other funds…………	2,416	8,551
Total………………………..	$63,614	$49,714

5. Allowance for Doubtful Accounts:

Accounts receivable are shown net of a $1,080,000 allowance for each year presented.

6. Property, Plant and Equipment:

The costs of property, plant and equipment and the related accumulated depreciation at June 30 are as follows:

	(Expressed in Thousands)	
	2000	1999
Land………………………………………………...	$ 12,232	$ 12,232
Buildings and improvements………………………….	358,916	358,916
Equipment……………………………………………..	47,511	45,441
	418,659	416,589
Less: Accumulated depreciation……………………...	265,913	258,497
	152,746	158,092
Construction in progress………………………………	253,547	215,065
Total………………………………………………...	$406,293	$373,157

Interest is capitalized on assets acquired with tax-exempt debt. The amount of interest to be capitalized is calculated by offsetting interest expense incurred from the date of the borrowing until completion of the project, with interest earned on invested proceeds over the same period. During fiscal years 2000 and 1999, interest expense of $5,823,000 and $6,171,000, respectively (net of interest income of $1,247,000 and $1,328,000, respectively), was capitalized.

At June 30, 2000, the Utility had outstanding commitments for construction of $40,174,000.

7. Debt (Other Than Revenue Bonds):

The Constitution of Maryland requires a three-step procedure for the creation of debt by the City of Baltimore:

- Act of the General Assembly of Maryland or resolution of the majority of Baltimore City delegates
- Ordinance of the Mayor and City Council of Baltimore
- Ratification by the voters of the City of Baltimore

A summary of outstanding debt (other than revenue bonds) applicable to the Utility (amounts expressed in thousands) as of June 30, 2000 and 1999 is as follows:

	2000	1999
General obligation bonds	$2,034	$2,729

The general obligation bonds bear interest at rates ranging from 4.0% to 9.0% and mature serially through 2011.

The following is a schedule of the principal and interest payments (amounts expressed in thousands) required as of June 30, 2000 to service the above debt payable by the Utility until maturity:

	General Obligation Bonds	
	Principal	Interest
2001	$ 349	$ 83
2002	284	61
2003	313	40
2004	86	26
2005	139	18
2006 and thereafter	863	504
Total	$2,034	$732

8. Revenue Bonds:

The City has issued project and refunding revenue bonds, the proceeds of which were used to provide funds for capital improvements of the Utility. Assets with a carrying value of $24,932,000 at June 30, 2000, and certain revenues of the Utility are pledged as collateral for the bonds and notes. Bonds and notes outstanding (amounts expressed in thousands) as of June 30 consist of:

	2000	1999
Serial bonds series 1993-A maturing in annual installments from $1,430,000 to $2,125,000 from July 1, 2000 through July 1, 2008, with interest ranging from 4.5% to 5.5%, payable semiannually…..	$ 15,750	$ 17,120
Serial bonds series 1994-A maturing in annual installments from $570,000 to $850,000 from July 1, 2000 through July 1, 2009, with interest ranging from 4.1% to 5.0%, payable semiannually……………………………………………………	6,975	7,520
Serial bonds series 1996-A maturing in annual installments from $685,000 to $1,070,000 from July 1, 2000 through July 1, 2009, with interest ranging from 4.5% to 5.55%, payable semiannually…………………………………………………...	8,605	9,260
Serial bonds series 1998-A maturing in annual installments from $505,000 to $835,000 from July 1, 2000 through July 1, 2012, with interest ranging from 3.75% to 4.8%, payable semiannually……………………………………………………	8,480	8,850
Serial bonds series 2000-A maturing in annual installments from $525,000 to $1,650,000 from July 1, 2001 through July 1, 2021, with interest ranging from 4.5% to 6.0%, payable semiannually……………………………………………………	21,025	-
Term bonds series 1993-A with interest at 5.6%, payable semiannually, due July 1, 2013……………………………………	12,200	12,200
Term bonds series 1993-A with interest at 5.65%, payable semiannually, due July 1, 2020……………………………………	23,900	23,900
Term bonds series 1994-A with interest at 6.0%, payable semiannually, due July 1, 2015……………………………………	6,250	6,250
Term bonds series 1994-A with interest at 5.0%, payable semiannually, due July 1, 2024……………………………………	30,475	30,475
Term bonds series 1996-A with interest at 5.8%, payable semiannually, due July 1, 2015……………………………………	7,845	7,845

Term bonds series 1996-A with interest at 5.5%, payable semiannually, due July 1, 2026……	23,115	23,115
Term bonds series 1998-A with interest at 5.375%, payable semiannually, due July 1, 2015……	2,765	2,765
Term bonds series 1998-A with interest at 5.0%, payable semiannually, due July 1, 2018……	3,220	3,220
Term bonds series 1998-A with interest at 5.0%, payable semiannually, due July 1, 2028……	14,890	14,890
Term bonds series 2000-A with interest at 5.75%, payable semiannually, due July 1, 2030……	19,880	-
Bond anticipation notes series 1999-A, water projects, floating interest rate, payable monthly, due June 30, 2000……	-	12,000
	205,375	179,410
Less unamortized charges……	1,099	1,373
	$204,276	$178,037

The term bonds series 1993-A due July 1, 2013, are subject to mandatory redemption at par prior to maturity by operation of a sinking fund on or after July 1, 2009, at annual principal amounts ranging from $1,100,000 to $1,350,000. The term bonds series 1993-A due July 1, 2020, are subject to mandatory redemption at par prior to maturity by operation of a sinking fund on or after July 1, 2014, at annual principal amounts ranging from $1,450,000 to $2,000,000. The term bonds series 1994-A due July 1, 2015, are subject to mandatory redemption at par prior to maturity by operation of a sinking fund on or after July 1, 2010, at annual principal amounts ranging from $895,000 to $1,200,000. The term bonds series 1994-A, due July 1, 2024, are subject to mandatory redemption at par prior to maturity by operation of a sinking fund on or after July 1, 2016, at annual principal amounts ranging from $1,265,000 to $6,320,000. The term bonds series 1996-A due July 1, 2015, are subject to mandatory redemption at par prior to maturity by operation of a sinking fund on or after July 1, 2010, at annual principal amounts ranging from $1,130,000 to $1,500,000. The term bonds series 1996-A due July 1, 2026, are subject to mandatory redemption at par prior to maturity by operation of a sinking fund on or after July 1, 2016, at annual principal amounts ranging from $1,585,000 to $2,710,000. The term bonds series 1998-A due July 1, 2015, are subject to mandatory redemption at par prior to maturity by operation of a sinking fund on or after July 1, 2013, at annual principal amounts ranging from $875,000 to $970,000. The term bonds series 1998-A due July 1, 2018, are subject to mandatory redemption at par prior to maturity by operation of a sinking fund on or after July 1, 2016, at annual principal amounts ranging from $1,020,000 to $1,125,000. The term bonds series 1998-A due July 1, 2028, are subject to mandatory redemption at par prior to maturity by operation of a sinking fund on or after July 1, 2019, at annual principal amounts ranging from

$1,185,000 to $1,835,000. The term bond series 2000-A due July 1, 2030, are subject to mandatory redemption at par prior to maturity by operation of a sinking fund on or after July 1, 2022, at annual principal amounts ranging from $1,750,000 to $2,735,000.

The serial bonds series 1994-A are subject to redemption prior to maturity beginning on and after July 1, 2004, at redemption prices ranging from 102% to 100% of the principal amount. The serial bonds series 1996-A are subject to redemption prior to maturity beginning on and after July 1, 2006, at redemption prices ranging from 101% to 100% of the principal amount. The serial bond series 1998-A are subject to redemption prior to maturity beginning on and after July 1, 2008, at redemption prices ranging from 101% to 100% of the principal amount. The serial bond series 2000-A are subject to redemption prior to maturity beginning on and after July 1, 2010, at par plus accrued interest.

Principal maturities and interest (amounts expressed in thousands) of revenue bonds are as follows:

	Principal	Interest
2001	3,190	$ 10,016
2002	3,860	10,737
2003	4,090	10,552
2004	4,295	10,354
2005	4,495	10,142
2006 and thereafter	185,445	132,779
	$205,375	$184,580

In prior years, the Utility also defeased revenue bonds by placing the proceeds of new debt issues in an irrevocable trust to provide for all future debt service payments on the old debt. Accordingly, the trust account assets and the liability for the defeased debt are not included in the Utility's financial statements. At June 30, 2000, $72,445,000 of debt outstanding is considered defeased.

The Utility has various revenue bond covenants that generally require the Utility to maintain rates sufficient to meet the operating requirements of the Utility and an operating reserve as defined in the revenue bond indentures. As of June 30, 2000, the rate requirements were met, and management believes the Utility is in compliance with all significant requirements of the indentures.

9. Retirement Plan:

Classified employees of the Utility are required to join the City of Baltimore's Employees' Retirement System (ERS). The ERS is a multi-employer defined benefit pension plan administered by the City of Baltimore Retirement System. The ERS provides retirement, disability and death benefits to plan members and beneficiaries. The plan is managed by a Board of Trustees in accordance with Article 22 of the Baltimore City Code. Plan benefits may be amended only by the City Council. The Utility's share of contributions to the plan were $1,016,000 in 2000 and $1,013,000 in 1999. ERS issues a publicly available financial report that may be obtained by writing to the City of

Baltimore Retirement Systems, Room 640 City Hall, 100 N. Holliday Street, Baltimore, MD 21202.

10. Postemployment Benefits:

City administrative policy provides that certain postemployment benefits, other than pension benefits, be provided to all employees of the Utility. These benefits include certain health care and life insurance benefits. All employees who retire are eligible to receive these benefits. Such benefits are accounted for on a cash basis so that payments during the current year represent benefit coverage for currently retired employees or their beneficiaries. During fiscal years 2000 and 1999, the Utility's share of the City postemployment benefit payments were $2,093,000 and $1,918,000, respectively.

11. Risk Management:

The Utility participates in the City's risk management program. The City is exposed to various risks of loss related to torts; theft of, damage to, and destruction of assets; errors and omissions; injuries to employees; and natural disasters. During fiscal year 1987, the City established the Risk Management Fund (an internal service fund) to account for and finance its uninsured risks. The City's risk financing techniques include a combination of risk retention through self-insurance and risk transfer through the purchase of commercial insurance. The Risk Management Fund services all claims for risk of loss, including general liability, property and casualty, workers' compensation, automobile physical damage and bodily injury and sundry other risks. Commercial insurance coverage is provided for each property damage claim in excess of $750,000 with a cap of $250,000,000. Settled claims have not exceeded this commercial coverage in any of the past five years. The City also provides medical insurance coverage for all employees and retirees. Employees are required to pay a percentage of the annual cost of the medical plans and the remaining costs are paid by the City's internal service fund.

All funds of the City participate in the program and make payments to the Risk Management Fund based on actuarial estimates and historical cost information of the amounts needed to pay prior and current year claims and to establish a reserve for catastrophic losses. During fiscal years 2000 and 1999, the Utility's share of the City's cost was $4,542,000 and $4,182,000, respectively.